



Goes the Market

U.S. Housing

All around the United States, too much money entered the housing market; that's the way the investors worked—pop goes the housing market.

It's done. It's over. The housing euphoria that gripped the nation over the past four years is finally exhausted. Rational analysts who have followed this economic phenomenon warned of its coming. The difficult part was predicting the timing of the fall. Based upon the rapidly growing inventory of unsold homes, rapidly deteriorating housing affordability, and fading home-builder confidence, the signs are strong that the time is now.

What concerns this analyst is the housing market's parallel with the stock market bubble of the late 1990s. That bubble was also warned about, but what made it worse was its continued growth at least two years beyond the onset of the initial cries for moderation. That's the parallel I see with the current housing situation and the previous dot.com bust. We knew the housing market was acting outside its historical norm, in many cases driven by aggressive investors looking for an alternative to a non-performing stock market. They pushed market prices well beyond what income levels suggest they should be. Economists know that double-digit year-after-year housing price appreciation is just not compatible with income gains that lag far behind. After all, you have to be able to afford your monthly mortgage payments!

An affordability index is a combination of the price of homes and the available mortgage interest rates. Together they heavily influence the affordability of a house in relation to the buyer's income. Over the past five years, a major contributor to rapidly rising housing prices has

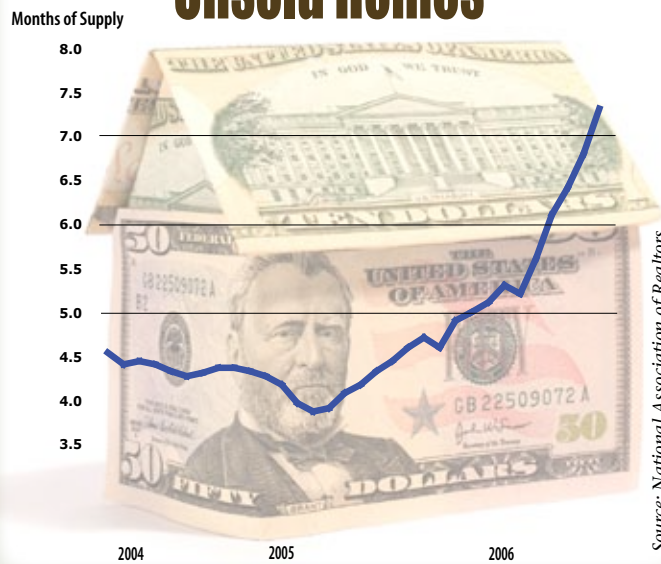
not only been rapidly falling mortgage interest rates, but also speculative (or portfolio) buying. In many markets, it was far-distant buyers who were determining the local price of homes, not the local people and their income levels (note St. George here in Utah). To keep local people buying, financial markets became more creative (but not always disciplined) in their financing schemes. Adjustable-rate and interest-only mortgages were pushed heavily. This financing is designed to get marginal buyers into the housing market, unfortunately with only a short-term view in mind. With rates now higher and these adjustments coming due in waves over the next two years, many of these people will discover that they no longer can afford their monthly housing payments.

The investors are backing out of the housing market—at least on the coasts, where the bulk of this overinvestment occurred. It's possible that it could shift inland to the markets that didn't get sucked up in this wave. But with interest rates rising, any housing-price increase in these lagging markets will probably be much more tempered than the doubling of prices that occurred in many of the large coastal markets. Any positives from a shift inward may not be enough to counter the anticipated negatives expected in the coastal regions.

Most of Utah dodged this wild housing price increase—except for St. George. Prices have risen rapidly along the Wasatch Front over the past year and a half, but the market will probably temper enough to keep that region out of trouble. St. George, on the other hand, is a market where the housing prices are not in line with the area's wage levels. It will be interesting to observe how this imbalance plays out over the next two years.

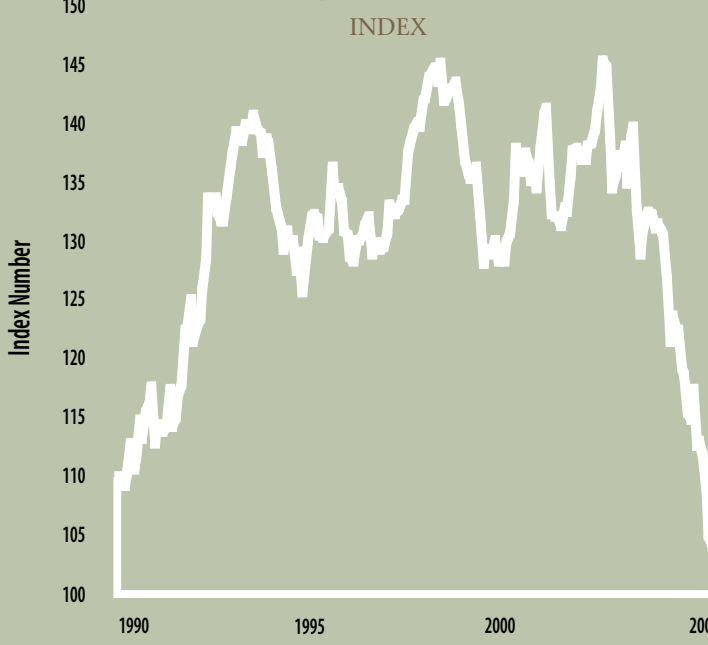
Nationwide Inventory of

Unsold Homes



Source: National Association of Realtors

Housing Affordability



Source: National Association of Realtors